



[4830-01-p]

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9625]

RIN 1545-BI83

Reimbursed Entertainment Expenses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding the exception to the deduction limitations on certain expenditures paid or incurred under reimbursement or other expense allowance arrangements. These final regulations affect taxpayers that pay or receive advances, allowances, or reimbursements under reimbursement or other expense allowance arrangements and clarify the rules for these arrangements.

DATES: Effective Date: These regulations are effective on **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

Applicability date: For date of applicability, see §1.274-2(f)(2)(iv)(F).

FOR FURTHER INFORMATION CONTACT: Patrick Clinton, (202) 622-4930 (not a toll free number).

SUPPLEMENTARY INFORMATION:

### **Background**

This document contains final regulations that amend the Income Tax Regulations (26 CFR part 1) under section 274(e)(3) of the Internal Revenue Code (Code). The

regulations provide rules for the exception under section 274(e)(3) to the section 274(a) and (n) deduction limitations for certain expenditures paid or incurred under reimbursement or other expense allowance arrangements. The final regulations clarify the definition of reimbursement or other expense allowance arrangements for purposes of section 274(a) and (n) and how the deduction limitations apply to reimbursement arrangements between more than two parties.

On August 1, 2012, a notice of proposed rulemaking (REG-137589-07) was published in the **Federal Register** (77 FR 45520). One written comment responding to the notice of proposed rulemaking was received. No public hearing was requested or held. After consideration of the comment, the regulations are adopted without substantive change by this Treasury decision.

### **Summary of Comment and Explanation of Provisions**

#### **1. Reimbursement Arrangements of Payors**

The proposed regulations would amend regulations that apply the section 274(e)(3) exception to reimbursement and other expense allowance arrangements involving employees. The proposed regulations clarify that these rules apply to reimbursement or other expense allowance arrangements between payors and employees. Under the proposed regulations, a payor may be an employer, an agent of the employer, or a third party.

The commentator suggested that the change in terminology is confusing and that the final regulations either should retain the term employer or further define the terms.

The regulations use the term payor to clarify that the rules relating to reimbursement and other expense allowance arrangements with employees do not

require determining who is the common law employer. The rules require, instead, identifying the party that bears the expense. Thus, the regulations are not limited to employers but encompass any party that reimburses an employee's expenses under a reimbursement or other expense allowance arrangement. Accordingly, the final regulations do not adopt this comment.

## **2. Arrangements Between Independent Contractors and Clients**

The proposed regulations provide that, for a reimbursement or other expense allowance arrangement involving persons that are not employees (an independent contractor and a client or customer), the parties may expressly identify the party subject to the section 274(a) and (n) limitations. If the agreement does not specify a party, the limitations apply to the client if the independent contractor accounts to the client for (substantiates) the expenses, and to the independent contractor if the independent contractor does not account to the client. The commentator suggested that the language of section 274(e)(3) does not permit the parties to choose which party is subject to the limitations.

Section 274(e)(3)(B) provides that taxpayers may identify the party subject to the section 274(a) and (n) limitations by accounting or not accounting for expenses and therefore contemplates identification of the party subject to the limitations. The final regulations provide a rule that gives taxpayers the flexibility contemplated under section 274(e) and is easily administrable for the IRS. Accordingly, the final regulations do not adopt this comment.

## **Effective/Applicability Date**

These regulations apply to expenses paid or incurred in taxable years beginning

after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. Taxpayers may apply these regulations to expenses paid or incurred in taxable years beginning on or before **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]** for which the period of limitation on credit or refund under section 6511 has not expired.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

### **Drafting Information**

The principal author of these final regulations is Patrick Clinton of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

## PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.274-2 also issued under 26 U.S.C. 274(o). \* \* \*

Par. 2. Section 1.274-2 is amended by revising paragraph (f)(2)(iv) to read as follows:

§1.274-2 Disallowance of deductions for certain expenses for entertainment, amusement, recreation, or travel.

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(iv) Reimbursed entertainment, food, or beverage expenses--(A) Introduction. In the case of any expenditure for entertainment, amusement, recreation, food, or beverages made by one person in performing services for another person (whether or not the other person is an employer) under a reimbursement or other expense allowance arrangement, the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1) apply either to the person who makes the expenditure or to the person who actually bears the expense, but not to both. If an expenditure of a type described in this paragraph (f)(2)(iv) properly constitutes a dividend paid to a shareholder, unreasonable compensation paid to an employee, a personal expense, or other nondeductible expense, nothing in this exception prevents disallowance of the

expenditure to the taxpayer under other provisions of the Code.

(B) Reimbursement arrangements involving employees. In the case of an employee's expenditure for entertainment, amusement, recreation, food, or beverages in performing services as an employee under a reimbursement or other expense allowance arrangement with a payor (the employer, its agent, or a third party), the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1) apply--

(1) To the employee to the extent the employer treats the reimbursement or other payment of the expense on the employer's income tax return as originally filed as compensation paid to the employee and as wages to the employee for purposes of withholding under chapter 24 (relating to collection of income tax at source on wages); or

(2) To the payor to the extent the reimbursement or other payment of the expense is not treated as compensation and wages paid to the employee in the manner provided in paragraph (f)(2)(iv)(B)(1) of this section (however, see paragraph (f)(2)(iv)(C) of this section if the payor receives a payment from a third party that may be treated as a reimbursement arrangement under that paragraph).

(C) Reimbursement arrangements involving persons that are not employees. In the case of an expense for entertainment, amusement, recreation, food, or beverages of a person who is not an employee (referred to as an independent contractor) in performing services for another person (a client or customer) under a reimbursement or other expense allowance arrangement with the person, the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1) apply to the party

expressly identified in an agreement between the parties as subject to the limitations. If an agreement between the parties does not expressly identify the party subject to the limitations, the limitations apply--

(1) To the independent contractor (which may be a payor described in paragraph (f)(2)(iv)(B) of this section) to the extent the independent contractor does not account to the client or customer within the meaning of section 274(d) and the associated regulations; or

(2) To the client or customer if the independent contractor accounts to the client or customer within the meaning of section 274(d) and the associated regulations. See also §1.274-5.

(D) Reimbursement or other expense allowance arrangement. The term reimbursement or other expense allowance arrangement means--

(1) For purposes of paragraph (f)(2)(iv)(B) of this section, an arrangement under which an employee receives an advance, allowance, or reimbursement from a payor (the employer, its agent, or a third party) for expenses the employee pays or incurs; and

(2) For purposes of paragraph (f)(2)(iv)(C) of this section, an arrangement under which an independent contractor receives an advance, allowance, or reimbursement from a client or customer for expenses the independent contractor pays or incurs if either--

(a) A written agreement between the parties expressly states that the client or customer will reimburse the independent contractor for expenses that are subject to the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1); or

(b) A written agreement between the parties expressly identifies the party subject to the limitations.

(E) Examples. The following examples illustrate the application of this paragraph (f)(2)(iv).

Example 1. (i) Y, an employee, performs services under an arrangement in which L, an employee leasing company, pays Y a per diem allowance of \$10x for each day that Y performs services for L's client, C, while traveling away from home. The per diem allowance is a reimbursement of travel expenses for food and beverages that Y pays in performing services as an employee. L enters into a written agreement with C under which C agrees to reimburse L for any substantiated reimbursements for travel expenses, including meals, that L pays to Y. The agreement does not expressly identify the party that is subject to the deduction limitations. Y performs services for C while traveling away from home for 10 days and provides L with substantiation that satisfies the requirements of section 274(d) of \$100x of meal expenses incurred by Y while traveling away from home. L pays Y \$100x to reimburse those expenses pursuant to their arrangement. L delivers a copy of Y's substantiation to C. C pays L \$300x, which includes \$200x compensation for services and \$100x as reimbursement of L's payment of Y's travel expenses for meals. Neither L nor C treats the \$100x paid to Y as compensation or wages.

(ii) Under paragraph (f)(2)(iv)(D)(1) of this section, Y and L have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(B) of this section. Because the reimbursement payment is not treated as compensation and wages paid to Y, under section 274(e)(3)(A) and paragraph (f)(2)(iv)(B)(1) of this section, Y is not subject to the section 274 deduction limitations. Instead, under paragraph (f)(2)(iv)(B)(2) of this section, L, the payor, is subject to the section 274 deduction limitations unless L can meet the requirements of section 274(e)(3)(B) and paragraph (f)(2)(iv)(C) of this section.

(iii) Because the agreement between L and C expressly states that C will reimburse L for substantiated reimbursements for travel expenses that L pays to Y, under paragraph (f)(2)(iv)(D)(2)(a) of this section, L and C have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(C) of this section. L accounts to C for C's reimbursement in the manner required by section 274(d) by delivering to C a copy of the substantiation L received from Y. Therefore, under section 274(e)(3)(B) and paragraph (f)(2)(iv)(C)(2) of this section, C and not L is subject to the section 274 deduction limitations.

Example 2. (i) The facts are the same as in Example 1 except that, under the arrangements between Y and L and between L and C, Y provides the substantiation of the expenses directly to C, and C pays the per diem directly to Y.



(ii) Under paragraph (f)(2)(iv)(D)(1) of this section, Y and C have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(C) of this section. Because Y substantiates directly to C and the reimbursement payment was not treated as compensation and wages paid to Y, under section 274(e)(3)(A) and paragraph (f)(2)(iv)(C)(1) of this section Y is not subject to the section 274 deduction limitations. Under paragraph (f)(2)(iv)(C)(2) of this section, C, the payor, is subject to the section 274 deduction limitations.

Example 3. (i) The facts are the same as in Example 1, except that the written agreement between L and C expressly provides that the limitations of this section will apply to C.

(ii) Under paragraph (f)(2)(iv)(D)(2)(b) of this section, L and C have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(C) of this section. Because the agreement provides that the 274 deduction limitations apply to C, under section 274(e)(3)(B) and paragraph (f)(2)(iv)(C) of this section, C and not L is subject to the section 274 deduction limitations.

Example 4. (i) The facts are the same as in Example 1, except that the agreement between L and C does not provide that C will reimburse L for travel expenses.

(ii) The arrangement between L and C is not a reimbursement or other expense allowance arrangement within the meaning of section 274(e)(3)(B) and paragraph (f)(2)(iv)(D)(2) of this section. Therefore, even though L accounts to C for the expenses, L is subject to the section 274 deduction limitations.

(F) Effective/applicability date. This paragraph (f)(2)(iv) applies to expenses paid or incurred in taxable years beginning after **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

\* \* \* \* \*

Par. 3. Section 1.274-8 is revised to read as follows:

§1.274-8 Effective/applicability date.

Except as provided in §§1.274-2(a), 1.274-2(e), 1.274-2(f)(2)(iv)(F), and 1.274-5, §§1.274-1 through 1.274-7 apply to taxable years ending after December 31, 1962.

Beth Tucker

Deputy Commissioner for Services and Enforcement.

Approved: June 25, 2013

Mark J. Mazur

Assistant Secretary of the Treasury (Tax Policy).

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